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The Commonwealth of Massachusetts

AUDITOR OF THE COMMONWEALTH

STATE HOUSE, BOSTON 02133

A. JOSEPH DENUCCI
AUDITOR



312066 0269 6109 3

TEL (617) 727-2075

June 26, 1996

[Letter to]

James J. Kerasiotes
Secretary of Transportation and Construction
MBTA Chairman
Ten Park Plaza
Boston, MA 02116-3969

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Dear Secretary Kerasiotes:

I have reviewed your recent letter and the accompanying report which you commissioned concerning my audit of the privatization of highway maintenance functions in Essex County. I should note that I received this material after it was distributed to the news media.

My office's review has concluded that the report by your hired consultant, Coopers & Lybrand, is seriously flawed and deficient, and contains numerous errors in arithmetic. This report, prepared by your long-time privatization consultant, appears to be nothing less than an attempt to damage the credibility of the Office of the State Auditor.

First, I must point out that the consultant's report, which cost the taxpayers over \$43,000, is not an Independent Auditor's Report, as you implied. It is totally lacking in all the customary characteristics required by professional auditing standards. An Independent Auditor's Report, which my office issues, is an attestation of the validity of financial information, verifying independently that the financial data as presented is supported by sufficient, competent and documented evidence.

The report by your consultant is replete with more than a hundred basic errors in arithmetic, which casts doubt on its credibility. Figures from support schedules do not add up and fail to tie into the main schedule. It erroneously claims as savings costs that were not part of the scope of the contract. In addition, you label as "savings" work that you contracted for which was not done. Your consultant's report misinterprets, misuses and uses inconsistently the guidelines promulgated under Chapter 296 of the Acts of 1993. I am also disappointed that your consultants, in allegedly evaluating my office's work, did not have the professional courtesy to contact my staff to understand what we did, how we did it and the basis for our findings.

The objective of our audit was to determine whether an adequate cost analysis had been performed by the Massachusetts Highway Department (MHD) to justify its decision to contract out certain maintenance functions and services, and whether MHD could substantiate its claims of savings and benefits. Our audit report clearly proved that MHD was unable to justify its decision, and your hired consultant would have come to the same conclusion had it performed a proper and objective audit rather than an assessment or review. Instead, your consultant simply accepted and used revised and erroneous information and figures which were supplied to it by MHD. In contrast, my office, throughout our audit process, attempted to gain access to adequate supporting documentation but was met with a constant lack of cooperation on the part of MHD. This led to significant delays and forced us to verify information from independent sources.

In our audit, because MHD failed to respond to our repeated requests for employee salary lists, we computed pre-privatization labor costs by using actual payroll costs based on the information MHD reported to the Internal Revenue Service on W-2 forms, a much more reliable source than the estimated payroll costs which your consultant used and which failed to take into account the amount of work that MHD employees performed on services that were not part of the scope of the privatization contract.

In order for cost comparisons to be valid and relevant, one must compare similar functions and levels of services, i.e. "apples with apples." You and your consultant make "apples and oranges" comparisons which are unacceptable, including:

- o Comparing pre- and post-privatization costs that were not part of the scope of the contract.
- o Comparing contract costs with the estimated contract price, without performing an audit of the costs.

Some of the flaws in your report are as follows:

OVERSTATEMENT OF IN-HOUSE LABOR COSTS AND SAVINGS

MHD provided your consultant with the names of 44 additional employees included in Attachment A costing well over \$1 million who were not originally considered by MHD as pre-privatization costs or part of the scope of the privatization contract at the time of our audit. It is clear that MHD and your consultant overstated the pre-privatization labor costs, which resulted in artificially inflated savings.

Under the contract, work to be performed was as follows: highway maintenance, bridge maintenance, drawbridge operations and maintenance, traffic maintenance and roadside maintenance. Some of the maintenance activities not covered by this contract include litter details, road resurfacing, crack sealing, bridge painting, snow and ice patrol, sanding and salting, snow removal and post-storm cleanup, rest area maintenance, repairing movable bridges, and painting road centerlines, edgelines and land markings. These activities were to be covered through other maintenance contracts, through the increased use of correctional inmate labor, or by the 31 state employees (from an original workforce of 141 employees) who, under the privatization plan, remained in Essex County.

You try to have it both ways by changing the numbers until you think you get the answer you want. Your own 1993 in-house cost analysis showed cost savings for 82 laborers of \$1.8 million, which does not agree with the numbers in your consultant's report. In fact, your consultant, in page 12 of its report, notes that your 1993 analysis allocated \$1.8 million in savings in a manner that resulted in double-counting those savings, as we pointed out in our report. Does MHD continue to maintain savings and benefits of \$11.8 million, as you originally claimed in your 1993 report, or are you now content with Coopers' alleged \$2.5 million in savings, a \$9.3 million downward adjustment to your original claim?

OTHER ARTIFICIALLY INFLATED SAVINGS UNDER THE CONTRACT

The appearance of savings was contrived because MHD deliberately limited performance by not having the contractor complete all the work required under the contract. As you are aware, the House Post Audit and Oversight Committee, as well as the Office of the State Auditor, have found evidence, including photographs, of numerous instances of work that was supposed to be performed by the contractor within the scope of the privatization contract but which was either not performed or performed by MHD employees, thereby artificially reducing the costs of the contract. Not only does this result in a deceptive cost comparison, but avoiding required work jeopardizes the safety of the public and also neglects the assets of the Commonwealth.

ERRORS IN ARITHMETIC

Your consultant's report contains so many elementary arithmetical errors that it should be an embarrassment. Attachment A of the report contains hundreds of errors: For example, under the pre-privatization period (FY92), employee number 49 is listed with regular gross pay of \$39,200, plus benefit of \$12,936, plus regular overtime of \$5,399, for an incorrect total of \$52,136. The correct total should read \$57,535. Also, the total personnel column of \$5,269,007 in Attachment A, the support schedule, (consisting of regular gross pay of \$3,868,770, benefit of \$1,276,694 and regular overtime of \$436,273), does not agree with the total of \$5,581,738 listed in Exhibit 2, the main schedule, a variance of over \$312,000.

A very faint, large watermark-like image of a classical building with four columns and a triangular pediment occupies the background of the page.

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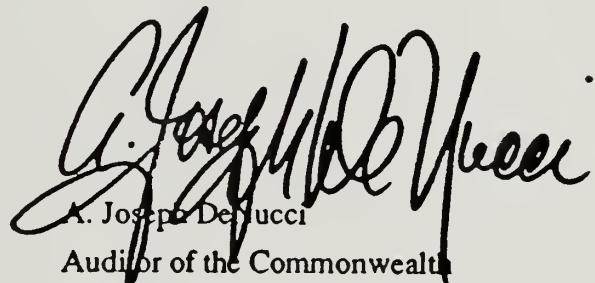
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Finally, on the privatization side of your cost comparison, similar mistakes occurred. In Attachment A, total personnel costs consist of salary \$1,107,517, benefit \$365,481 plus overtime \$79,194, for a total of \$1,511,983, while the same costs in Exhibit 2 are listed as totaling \$1,552,191, a variance of over \$40,000. Also, in the Executive Summary on Pages 2 and 11, your consultant subtracts \$4.7 million from \$7.1 million and ends up with \$2.5 million. In reality, the arithmetic comes to \$2.4 million, a \$100,000 variance. I have no doubt that these errors will be minimized by saying that they are immaterial or that, regardless of the errors, the consultant reached the correct conclusion. But 2 plus 2 is still 4, even for national firms. Also, the top of Attachment A labeled FY'92 as July 1, 1992-June 30, 1993, which is actually Fiscal Year 1993.

You commissioned this consultant to produce the results you sought. I, as the elected Auditor of the Commonwealth, work for the taxpayers. I cannot accept figures from an auditee without verification. Your consultant's report is a waste of taxpayers' money.

I can assure you that I will continue to perform my sworn statutory and constitutional duty in an independent, objective and fair manner and will not be deterred by your attempt to impugn the professionalism and competence of my office.

Sincerely,



A. Joseph DeRucci
Auditor of the Commonwealth

cc: House Committee on Post Audit and Oversight
Office of the Inspector General
Board of Public Accountancy
Department of Procurement and General Services

